

Preliminary Survey Memorandum

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APPROVED:

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**SEWER SERVICE AND USE CHARGE FUND
(FUND 541)**

The Sewer Service and Use Charge (SSUC) fund audit is the first in a series of four scheduled audits of the Environmental Services Department's (ESD) wastewater programs. The remaining audits on the workplan are three sewer-related divisions of ESD: Environmental Enforcement, Water Pollution Control Plant (WPCP), and Technical Services.¹

The SSUC fund is an enterprise fund that accounts for sewer charges to residential and commercial users. The revenue generated from these charges supports the financing, construction, maintenance, and operation of the sanitary sewer system. In addition, the fund provides San Jose's share of the financing of the capital and operating needs of the San Jose-Santa Clara Water Pollution Control Plant (WPCP).²

ESD is responsible for administering the activities of the SSUC fund, and operation and maintenance of WPCP. Other city departments have related responsibilities. The department of Streets & Traffic maintains the sanitary sewer and storm drainage systems. The department of Public Works designs sewer and storm drainage projects, awards the sewer and storm drain contracts, provides field inspection and contract administration for those projects, and prepares the storm and sanitary capital improvement budgets. The Treasury Division of the Finance Department bills most sewer fees.

SEWER SERVICE AND USE CHARGES

Every year, in conformance with Municipal Code requirements, the City Council reviews the rate structure for sewer charges and approves adjustments to the rate schedules as needed to support eligible program costs.³ In 1996-97, the City collected \$50.0 million in sewer service and use charges from residential customers, \$12.9 million from commercial customers, and \$4.5 million from industrial customers.⁴

¹² B-2.10/4-599³ B-2.13/3-1⁴

Sewer service and use charges have remained at the same level since 1994-95, and no increase was recommended for 1997-98. The standard charge for a single-family household is \$227.52 per year⁵ (\$18.96 per month).⁶ Commercial customers are billed based on industry type and estimated wastewater flow. Flow is based on water usage (obtained from water company records) less an agreed-upon allowance for loss and/or usage.⁷ Mike Escobedo from ESD's Source Control Unit approves flow adjustments.⁸ Table __ shows the adopted 1997-98 SSUC rates.

⁵ B-2.10/4-599

⁶ B-2.13/3-3

⁷ B-1.8/1-1

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TABLE __
1997-98 SEWER SERVICE AND USE CHARGES RATES⁹

TYPE OF CUSTOMER	ANNUAL CHARGE
Single family residential	\$227.52 per unit
Multi-family residential, condominiums, and mobilhome parks	\$130.20 per unit
Miscellaneous commercial	\$1.72 per 100 cubic feet (*)
Wineries	\$4.41 per 100 cubic feet (*)
Paper pulp mills	\$3.34 per 100 cubic feet (*)
Restaurants	\$3.07 per 100 cubic feet (*)
Automotive steam cleaners	\$3.06 per 100 cubic feet (*)
Dairy product processors	\$2.99 per 100 cubic feet (*)
Wholesale bakeries	\$2.55 per 100 cubic feet (*)
Soft drink bottlers	\$2.52 per 100 cubic feet (*)
Machinery manufacturers	\$2.28 per 100 cubic feet (*)
Printing plants	\$2.20 per 100 cubic feet (*)
Meat packers	\$2.10 per 100 cubic feet (*)
School, colleges and universities	\$1.95 per 100 cubic feet (*)
Repair shops and service stations	\$1.90 per 100 cubic feet (*)
Hotels and motels	\$1.86 per 100 cubic feet (*)
Hospitals and convalescent homes	\$1.81 per 100 cubic feet (*)
Domestic laundries	\$1.71 per 100 cubic feet (*)
Film service laboratories	\$1.69 per 100 cubic feet (*)
Car washes	\$1.61 per 100 cubic feet (*)
Plating works, soft water services	\$1.55 per 100 cubic feet (*)
Electrical equipment manufacturers, commercial, industrial, condominium or miscellaneous premises other than mentioned above	\$1.72 per 100 cubic feet (*)

(*) Discharge is based on estimated flow during the previous January to March. It is calculated using water meter readings less an agreed-upon allowance for loss and/or usage.

Sewer Rate Comparison

The 1997-98 budget includes \$350,000 for a comprehensive review and appraisal of sewer rates. According to ESD, the current rate structure was established in the late 1970's to conform to SWRCB guidelines. ESD is in the process of preparing the RFP. The study will evaluate changes in sewer discharge patterns to ensure that the rate structure remains equitable; the consultant will not be looking at the overall revenue that the City receives.¹⁰

⁹ B-2.13/4-1

It is interesting to note that a 1994 Ernst & Young national wastewater rate survey included 13 California jurisdictions, of which San Jose was one. At that time, San Jose's residential rates were higher than the other jurisdictions, while San Jose's commercial and industrial rates were mid-range. At that time, San Jose was the only one billing semi-annually; others were billing monthly or bi-monthly.¹¹

Table __ shows a comparison of residential sewer rates among WPCP users ("the tributary agencies").

TABLE __
COMPARISON OF WPCP TRIBUTARY AGENCIES' SINGLE FAMILY
RATES FOR 1996-97 AND 1997-98¹²

Agency	1996-97 Rate	1997-98 Rate	Increase
San Jose	\$ 227.52	\$ 227.52	\$ 0
Santa Clara	91.20	96.00	4.80
West Valley	198.00	198.00	0
Cupertino	216.00	216.00	0
Milpitas	237.60	237.60	0
District 2-3	270.00	270.00	0
Burbank	181.61	196.11	14.50
Sunol	160.00	160.00	0

As Table __ shows, although Santa Clara is a co-owner with San Jose of WPCP, Santa Clara's sewer rates are substantially lower than San Jose's rates. According to ESD staff, there may be several reasons for this:

- San Jose has 3 rates (SFD, MFD and mobile homes) where Santa Clara has one blended rate.
- San Jose has extensive water conservation programs that are funded by sewer rates.
- Santa Clara's overhead is probably lower. The city administration is smaller, and they don't apply a General Fund overhead rate -- each fund pays a straight charge.
- Santa Clara's residential base is much smaller; commercial probably subsidizes residential.
- Santa Clara recently adopted a 5-year ordinance to increase sewer rates 5 percent per year for the next 5 years.¹³

¹¹ B-3.6/1-1

¹² B-3.6/2-2

¹³ B-2.2/1-3

OTHER SEWER FEES AND CHARGES

The City levies a number of fees to support its sewer and wastewater treatment services. In addition to the sewer service and use charges described above, the City charges sanitary sewer connection fees, sewer lateral permit fees, and side sewer installation fees.

Sewage treatment connection fees

In 1996-97, the City collected approximately \$5.8 million in sewage treatment connection fees. These fees are deposited to the Sewage Treatment Connection Fee Fund (Fund 539) which is being used to support the annual debt service payments on the CWFA bonds.¹⁴ These fees are administered by Public Works.¹⁵

Sanitary sewer connection fees

In 1996-97, the City collected approximately \$2.4 million in sanitary sewer connection fees. These fees are used to support the Sanitary Sewer Connection Fee Fund (540).¹⁶ The City's five-year economic forecast projects 14% increase in sanitary sewer connections fees over previous forecasts, however annual revenues are expected to decline from 1998-99 levels (based on declining building and construction projections).¹⁷ These fees are administered by Public Works.¹⁸

Sewer lateral permits

The Public Works department bills customers for sewer lateral permits. The 100 percent cost recovery fee is \$687 per permit; estimated \$17,000 annual revenue.¹⁹ This revenue is deposited to the General Fund.²⁰

Side sewer installations

The Streets and Traffic Department bills customers for side-sewer installations. The 100 percent cost recovery fee is \$1,500 per installation; estimated \$44,500 annual revenue.²¹ This revenue is also deposited to the General Fund.²²

MUNICIPAL CODE PROVISIONS

¹⁴ B-2.10/5-673

¹⁵ Interview

¹⁶

¹⁷ B-2.9/1-1

¹⁸ Interview

¹⁹ B-3.1/2-105

²⁰ B-2.2/6-1

²¹ B-3.1/2-121

²² B-2.2/6-1

Chapter 15.12 of the Municipal Code establishes sanitary sewer service and use charges and outlines billing procedures. Part 3 specifies that:

- Revenues should be used only for the acquisition, construction, reconstruction, maintenance and operation of the sanitary sewer system of the city of San Jose, to repay principal and interest on any bonds or to repay federal or state loans or advances made to the city for the construction or reconstruction of sanitary or sewerage facilities; provided no such revenue be used for the acquisition or construction of new local street sewers or laterals as distinguished from main trunk interceptor and outfall sewers. Section 15.12.450.
- All premises in the City subject to charges are being charged for services (the only exceptions are premises that fall under another sanitation district's jurisdiction). Section 15.12.480
- The Director of water pollution control reviews the sewer service and use charges rates annually to assure their adequacy in fulfilling state and federal government requirements and to assure their adequacy in recovering capital costs, industrial cost recovery, and costs of operation and maintenance of the sanitary sewer system. Section 15.12.510
- Industrial or commercial property owners who are directed to install and maintain measurement and sampling devices for the purpose of computing sewer service and use charges shall do so within 60 days. Section 15.12.520
- The Director of water pollution control has determined the adequacy and appropriateness of methods employed to measure the volume of sanitary sewage, industrial wastes, and amount of biochemical oxygen demand the amount of suspended solids and the amount of ammonia discharged into the sanitary sewer system for the purpose of computing the sewer service and use charges as set forth in the resolution. Section 15.12.530
- The Finance director or the director's representative shall mail a bill or invoice to the owners of the commercial, industrial, or miscellaneous premises within sixty days from the end of each calendar month.
- Prior to collection on the tax roll, (1) the director of Finance prepares and files with the city clerk before July 5, a written report containing a description of each and every parcel of real property receiving the sewer services, (2) the city clerk should place notice of a hearing in a San Jose newspaper, (3) the city council shall hear all protests and then adopt or revise the report, (4) before August 10 the director of Finance shall cause charges to be placed on the property tax roll. Section 15.12.550

- The director of Finance semi-annually on or after October 1 shall bill (1) premises omitted from the report and (2) any governmental or public premises not subject to property taxes. Section 15.12.570
- A ten percent penalty is imposed on all delinquent charges. Section 15.12.610 (Section 15.12.600 a charge is delinquent if not paid on or before the 40th day immediately following the date the charge became due.) City enforcement powers for the payment of delinquent charges are detailed at section 15.12.670.
- All revenues collected shall be placed in a special Sewer Service and Use Charge fund. Such revenues may be used for the purpose specified in Section 15.12.450 and for no other purpose except for direct and administrative costs of the Finance Department in collecting the sewer service and use charges and for direct and administrative costs of the department of public works in performing any task in connection with the collection of sewer service and use charges. Interest may be credited to the General Fund or any other fund in the discretion of the city council [Note that the Attorney's Office has opined that this transfer of interest should be discontinued because of Proposition 218.] Section 15.12.640.

Chapter 15.16 authorizes Sanitary Sewer and Sewage Treatment Plant Connection Fees "to derive revenue which shall be used only for the construction and reconstruction of the sanitary sewer system of the city of San Jose and for the acquisition of land for such system."²³ It also establishes the San Jose-Santa Clara Clean Water Financing Authority Payment Fund.

Domestic septic tank cleanings are regulated pursuant to Chapter 9.08 which establishes receiving station service fees and charges to regulate the discharge of domestic septic tank cleanings into receiving station facilities at the San Jose-Santa Clara Water Pollution Control Plant, to regulate such delivery and discharge and establish a permitting process, to derive revenues to be used for the receiving station and sewage treatment plant facilities,²⁴ and directs the Finance department to collect the delivery records and prepare and mail invoices for fees and charges incurred during the month.²⁵

STATE WATER RESOURCE CONTROL BOARD (SWRCB) REVENUE PROGRAM REQUIREMENTS

According to ESD, the State Water Resources Control Board's "Revenue Program Guidelines for Wastewater Agencies" (4/83) apply. These guidelines require the City to prepare and formally document the determination of a system of user charges.²⁶ The revenue program is designed to provide a source of revenues that satisfies federal

²³ X-19/1-2850.2

²⁴ X-19/1-1717

²⁵ X-19/1-1721

²⁶

grant regulations.²⁷ The guidelines specify what can be included as operating and maintenance expenses, debt service, capital reserves, and operating reserves. It specifies how to allocate charges and expenses to users, and the basis for setting rates (e.g. flow versus charges for specific discharges, pro-ration of capital costs among users).²⁸

A working copy of the 1994-95 revenue program that ESD prepared to meet these guidelines includes: source and use summary, list of users, distribution of capital costs by user, distribution of operations and maintenance costs by user, distribution of annual sewer service charges by user, allocation of cost to parameters (e.g. flow), summary of annual loadings, and distribution of replacement allowance by tributary agency.²⁹

Every March, in compliance with these regulations, ESD sends the tributary agencies an annual estimate of the distribution of operating and maintenance costs. These reports show the tributary agencies' shares of estimated costs for the coming year.³⁰ ESD also prepares and sends annual estimates of the projected distribution of estimated capital costs for the coming year.³¹

THE IMPACT OF PROPOSITION 218

Proposition 218 was adopted by the voters of the state of California in November 1996.³² In general, the intent of Proposition 218 was to ensure that all taxes and most charges on property owners are subject to voter approval. In addition, Proposition 218 seeks to curb some perceived abuses in the use of assessments and property-related fees, specifically the use of these revenues to pay for general government services rather than property-related services.³³ Thus, Proposition 218 requires that the amount of the property-related fee may not exceed the cost of government to provide the service.³⁴ The proposition does not preclude diversion of fee revenue to the General Fund where it can be demonstrated that it is a reasonable share of overhead.³⁵

In January 1997, the City established Proposition 218 compliance implementation teams.³⁶ Apparently, the decision has been made that the City should bring sewer service and use charges into compliance with Proposition 218. Thus, the 1997-98 budget discontinues the transfer of interest from the sewer fund to the General Fund.³⁷ According to the Administration,

²⁷ B-3.2/5-1

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²⁹ B-2.8/2-1

³⁰ B-2.9/2-1 thru B-2.9/4-1

³¹ B-2.9/5-1 thru B-2.9/7-1

³² B-3.2/

³³ B-3.2/4-2

³⁴ B-3.2/4-7

³⁵ B-3.2/4-0

³⁶ B-3.2/

³⁷ B-2.10/4-602

If these charges were to be determined to be property-related under the provision of the new law, none of the proceeds of those charges could be used for general purposes. As a result, the transfer of interest earnings from the ... [fund] to the General Fund has been proposed to be eliminated... With these changes, the City would be in compliance with the substantive provisions of Proposition 218.³⁸

In addition, ESD is preparing an RFP to hire a consultant to review the rate structure ensure that individual rates are proportional to use (e.g. the residential coefficient to calculate BOD is 250 PPM which may or not still be a correct assumption).³⁹

However, analysts of Proposition 218 contend that fees that vary by level of service should not be considered a property-related fee, because they are based on service usage rather than property ownership. Because Proposition 218 does not restrict non-property-related fees, the definition of the term is important.⁴⁰ According to a recent Western City article, the proposition only applies to fees that are imposed as an incident of property ownership and that have a direct relationship to property ownership. According to the article, the state attorney general has issued an opinion that a tiered rate structure does not violate Proposition 218 because the rate structure is based on usage. The article also concludes regulatory fees are also exempt.⁴¹

Guidance from the state and/or the courts with regards the applicability of Proposition 218 to specific types of fees has not been definitive.⁴² According to the Legislative Analyst's Office,

There is little consensus as to what constitutes a "property-related fee", however, Proposition 218 explicitly exempts from this definition gas and electric charges and fees imposed as a condition to property development.⁴³

It appears that at least sewer connection fees and treatment plant connection fees are clearly exempt because they are development-related. Proposition 218's applicability to sewer service and use charges is less clear.⁴⁴

DIVISION OF RESPONSIBILITY FOR SSUC BILLING

Residential and Commercial Sewer Billing (Treasury)

The Sewer Billing Unit of the Treasury Division of the Finance department bills and collects sewer fees from approximately 212,000 customers,⁴⁵ including 164,000 single-family dwellings,⁴⁶ other residential and commercial customers, and

³⁸ B-2.13/3-3

³⁹ B-1.8/1-1

⁴⁰ B-3.2/4-7

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⁴³ B-3.2/3-2

⁴⁴ Opinion

⁴⁵ B-0/2-3..4

⁴⁶ B-2.2/3-3

approximately 3,000 newly identified accounts each year.⁴⁷ This amounts to approximately \$64.0 million out of \$68.4 million in sewer fees.⁴⁸ The 1997-98 budget for Fund 541 includes \$427,000 in collection costs to cover the expenses of the Sewer Billing Unit.⁴⁹ The key staff in Sewer Billing is Ken Stone and Janice Tenario.⁵⁰

The Sewer Billing Unit uses a database to track and bill its customers. Customers are assigned one of 35 standard industry codes (SIC). Each SIC has an associated rate as established by the City Council in the annual sewer fee resolution.⁵¹ Table ___ is a summary of that database as of August 5, 1997.⁵²

**TABLE –
SUMMARY OF SEWER DATABASE AS OF AUGUST 5, 1997⁵³**

TYPE	NUMBER OF RECORDS	SERVICE CHARGE
Single Family Dwelling	164,395	37,401,038
Multiple Dwelling/Mobile Homes	30,004	13,285,835
Commercial	20,375	14,270,916
Government/Schools	3,110	1,529,056
TOTAL	217,884	66,486,845

The sewer database is located on one of the City's central computer systems – the VAX. Cameron Cleland is the responsible IT programmer.⁵⁴ Bill Hewitt (of our office) is currently working on an audit of property taxes which involves determining the completeness of the customer listing in the sewer database, reviewing county fees for processing sewer charges, and reviewing the county's remittance of fees (including sewer fees). We will coordinate our work, and hope to rely on his work in terms of the accuracy of the sewer database customer listing (but not with regards the appropriateness of sewer charges).⁵⁵

Commercial customers are billed per 100 cubic feet of water used (as measured from January through March). Sewer Billing gets water company information on tape cartridges every quarter, and loads the information into the database. Staff run exception reports for negative or zero water usage, and then verify each of those cases by hand.⁵⁶

⁴⁷ B-0/2-3..4

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⁴⁹ B-2.10/1-1

⁵⁰ B-2.2/3-2

⁵¹ B-2.7/5-1

⁵² B-2.7/2-1

⁵³ B-2.7/2-1

⁵⁴ B-2.2/3-1

⁵⁵ B-2.7/1-1

⁵⁶ B-2.2/3-1

Each commercial customer has a standard industry code (SIC); charges per 100 cubic feet of water flow vary for each SIC (rates are set by the City Council for each SIC). Loss adjustment factors are applied to laundries (89 percent of water use) and concrete companies (percent varies by company). Sewer Billing works very closely with the Source Control Unit at WPCP (especially Mike Escovedo) on loss rate adjustments; Source Control is responsible for determining the adjustment factors.⁵⁷

The City places customer charges on the property tax rolls once per year. The City pays Santa Clara County a one percent fee to process its sewer and storm drain billings and payments. The City Auditor's Office is involved in the ongoing dispute over the county agreement (Bill Hewitt is working on this issue).⁵⁸ The 1997-98 fee is estimated at \$625,000.⁵⁹

The Sewer Billing Unit issues pro-rated, mid-year invoices for new residential and commercial customers (pro-rated to the next property tax assessment date). In addition, the Sewer Billing Unit issues monthly invoices to government facilities because they are not on the County's property tax rolls. Sewer Billing enters batch total onto FMS. The invoices are tracked on Treasury's A/R system (on the VAX). Treasury's Payment Processing Unit handles all remittances. Treasury investigators are available to track down non-payments of invoices, however the Sewer Billing Unit usually just applies the 10 percent penalty and places the delinquent amount on the tax roll the next year.⁶⁰

Industrial Sewer Billing (ESD)

The Fiscal Services unit in the Administrative Services division of ESD hand bills approximately 40 industrial accounts on a monthly basis (\$4.4 million out of \$68.4 million in annual sewer fees).⁶¹ The Environmental Enforcement division is responsible for monitoring businesses whose flow exceeds 25,000 gallons per day⁶² (the Planning Department refers all major new developments to ESD for a discharge permit)⁶³. The Environmental Enforcement division pulls sewage samples from these companies because charges are based on volume and strength of sewage (flow, BOD, suspended solids). In other instances, charges are based on some other factor. For example, large meat packers pay sewer fees based on the number of cattle handled. They pull the samples at the same time that they check of other environmental compliance issues, however compliance billing is handled separately (and those revenues go directly to Fund

⁵⁷ B-2.2/3-1

⁵⁸ Office discussions with Bill.

⁵⁹ B-2.10/1-1

⁶⁰ B-2.2/3-1

⁶¹ B-0/2-4

⁶² B-2.2/1-2

⁶³ B-2.2/2-3

514). If strength and volume prove to be consistent, the company is billed based on an average so that we can all avoid the expense of sampling and testing.⁶⁴

The Administrative Services division prepares the invoice (they track the companies and produce the bills using a series of PC spreadsheets), and attaches worksheets showing the calculation of fees so that companies can verify the charges.⁶⁵ According to ESD staff, there are very few disputed bills – perhaps one per year.⁶⁶ The Accounts Receivable section at Treasury collects and monitors remittances, and assesses late fees when applicable.⁶⁷

OVERSIGHT ROLE OF ESD'S ADMINISTRATIVE SERVICES DIVISION

The Accounting Services section provides oversight of the SSUC Fund. They track sewer and wastewater revenues and expenditures, bill industrial sewer users, and will begin billing water retailers for recycled water once the SBWRP is operational.⁶⁸ The Administrative Services Division also provides other support services for ESD. Peter Jensen is the Division Manager (Administrative Officer). Other key division personnel who administer Fund 541 are John Lopez (Supervising Accountant) and Dorothy McGinley (Sr. Accountant).⁶⁹ The Administrative Services budget for 1997-98 (in total) is approximately \$4.6 million (49 FTE).⁷⁰

Personal Services Cost Allocation Study

ESD has always charged personal services to various funding sources based on management's best estimate of the workload. In February 1998, David M. Griffith Associates (DMG) completed a cost allocation study of personnel services for ESD,⁷¹ including time studies of workgroups that have multiple funding sources.⁷² DMG offered two major recommendations: (1) use an allocation method to assess ESD funds for admin costs, and (2) accumulate time reports from other divisions to use as the basis for distributing staff costs to ESD funds. However, according to the final DMG report, ESD elected to continue distributing admin staff directly to ESD funds benefiting from these services. DMG understood that ESD would use the DMG cost analysis of Administrative Services and the other divisions to prepare the 1996-97 budget.⁷³

⁶⁴ B-2.2/1-2

⁶⁵ B-2.2/1-2

⁶⁶ B-2.2/2-3

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⁶⁹ B-2.2/1-1..2

⁷⁰ B-2.10/5-329

⁷¹ B-2.8/1-1

⁷² B-2.2/6-1

⁷³ B-2.8/1-1

WASTEWATER FUND ACCOUNTING

The City accounts for its sewer and wastewater services in a number of funds. On the CAFR, these funds are accounted for as enterprise funds and roll up into the Wastewater Treatment System. The Wastewater Treatment System has \$210 million in pooled cash and investments held in the City's Treasury division.⁷⁴ A brief description of the separate funds follows (in numerical order).

Fund 512 - Treatment Plant Capital

Established April 6, 1959. Administered by ESD; included in the City's capital budget. This fund was established for identifying and tracking each participant's interest in each of the referenced areas related to the plant. This fund is used to account for expenses related to improvement, enlargement or expansion of the wastewater treatment plant.

Fund 513 - Treatment Plant Operating

Established October 22, 1956. This fund accounts for operations and maintenance of WPCP. The fund is administered by ESD, and is included in the City's operating budget. The purpose of this fund is to account for the operating costs and expenses of the City's sewage treatment plant. The source of funds comes from contributions from participants in the wastewater treatment system. The 1997-98 adopted operating budget shows a \$6.5 million contribution from the city of Santa Clara, interest of \$1.8 million, and interfund transfers from the SSUC Fund and the Treatment Plant Income Fund. Primary expenditures include ESD personal services (\$22.2 million), ESD non-personal expenses (\$25.6), General Fund overhead of \$2.5 million, and other expenses of \$0.8 million.

The 1997-98 unrestricted fund balance in Fund 513 is \$18.6 million. In addition there is a \$2 million reserve for Workers' Compensation claims. According to ESD staff, the unrestricted fund balance belongs to San Jose because we keep the tributary agencies whole on an annual basis. In other words, San Jose credits current year overpayments against next year's contributions. ESD is currently drawing down the fund balance to bring it into conformance with the City's written guidelines. According to ESD staff, there are several reasons why the fund balance has gotten so high:

- WPCP is making on-going efforts to cut the budget; they have underspent their budget the last 3-4 years. This year the operating budget is \$2 million less than prior year.
- In addition, they feel they need to keep sufficient cash in this fund since they only get money from the County (that is, sewer fees) twice a year.⁷⁵

Fund 514 - Treatment Plant Income

⁷⁴ CAFR 6/30/97 p. 129, 154

⁷⁵ B-2.2/1-4

Established May 6, 1959. This fund accounts for revenues received from tributary agencies in accordance with the master agreement. Revenue is received by Treasury. The accumulated revenues are then transferred to the Treatment Plant Capital Fund and the Treatment Plant Income Fund upon approval by the City Council. The 1997-98 budget shows transfers out to WPCP operating (\$11.9 million) and WPCP capital (\$3 million). The 1997-98 budget also includes a \$1 million transfer in from San Jose's SSUC Fund. The fund is administered by ESD.

Fund 530 - South Bay Water Recycling.

Established November 1995. A memo fund to the Treatment Plant Capital Fund (512); administered by ESD. According to the bond documents and the tax certificates, bond proceeds and expenses have to be accounted for separately for arbitrage purposes. For this reason, this fund is established as a memo to Fund 512 to account for the transfer of bond proceeds from the Clean Water Financing Authority and to account for expenditures related to the South Bay Water Recycling project.

Fund 531 - Treatment Plant Renewal and Replacement Reserve.

Established July 1, 1987. A memo fund to the Treatment Plant Capital Fund (512); administered by ESD. This fund was created to comply with the provisions of the issuance of the 1982 Revenue Bonds (subsequently replaced with the 1983 Revenue bonds which were replaced with the 1987 Revenue bonds), which required a reserve to pay the cost of extraordinary repairs, renewals and replacements of treatment plant facilities. The source of funds comes from contributions from participants in the wastewater treatment system. This fund is required to maintain a balance of \$5 million or more as required by the Clean Water Financing Authority 1982 Revenue Bond Agreement.

Fund 534 - South Bay Water Recycling Project Grant.

Established May 1995. A memo fund to the Treatment Plant Capital Fund (512); administered by ESD. This fund was established to account for grant revenues and revenues received from other external agencies (i.e. State or Federal funds). This revenue is used to pay expenses related to the construction of the facilities to treat wastewater. This revenue can only be used after bond proceeds in Fund 530 are used.

Funds 537 and 538 - Clean Water Finance Authority Payment Funds

Established November 1995 (537) and March 1983 (538). This fund was established to account for contributions received from the city and tributary agencies for bond payments. All moneys in the payment fund shall be used by the city for the sole purpose of paying base payments and additional payments to the Clean Water Financing Authority or Trustee, as such become due and payable pursuant to the Improvement Agreement. Interest, if any shall be allocated to the contributors in proportion to their

share of contributions to the fund. According to ESD staff, this fund does not need budget approval because by definition the bond payments are already appropriated.

According to ESD staff, CWFA series 87A bonds were used to upgrade the plant. Fund 541 pays for the debt service on those bonds because the upgrade benefits current users. The CWFA series 87B bonds and 1995 bonds were used to expand WPCP and finance the SBWRP. Debt service on those bonds is paid out of the Sewage Treatment Connection Fee Fund (Fund 539) because the expansions will benefit future users.⁷⁶

Fund 539 - Sewage Treatment Plant Connection Fee.

Established July 1, 1976. Fund 539 was established to account for revenues from the Sewage Treatment Plant Connection fees. These fees can only be used for the acquisition, financing, construction, reconstruction and enlargement of the City's sewage treatment plant and to repay federal/state loans or advances made to the City for the acquisition, construction, reconstruction and enlargement of the sewage treatment plant, and to repay principal and interest on any bonds which have been or may be issued for the sewage treatment plant. Reserve requirements -- to set aside approximately 1 percent of the value of the sewage treatment plant per year in the replacement account.

The 1997-98 budget shows interest in the connection fee fund as zero. That interest is apparently being credited directly to the General Fund, instead of being shown as revenue in Fund 539 that is transferred out.⁷⁷

There are several outstanding loans from Fund 539 to other City funds. These loans are shown on the CAFR as "advances to other funds."⁷⁸ They include to the:

- Storm Drain Service and Use Charge Fund (Fund 446) in 1991-92 for \$1.4 million (the original amount of this loan was \$5.1 million);
- Fiber Optics Development Fund (Fund 007) in 1995-96 for \$5.2 million; and
- Building and Structures Construction Tax Fund (Fund 429) in 1996-97 for \$5.9 million.⁷⁹

Fund 540 - Sanitary Sewer Connecting Fee.

Established July 1, 1959. This fund accounts for the revenues from the sewer connection fees to be used for the construction, improvement and extension, including the acquisition of real property, of the sanitary sewerage system of the City, excluding treatment facilities, and for payment to public agencies for use of their sewer system.⁸⁰ The fund is administered by Public Works, and is included in the City's capital budget. In 1997-98, the beginning fund balance in fund 540 was \$38.2 million. This is an

⁷⁶ B-2.2/1-4

⁷⁷ B-2.2/2-2

⁷⁸ CAFR 6/30/97, p. 129

⁷⁹ B-2.10/9-1

⁸⁰ X-5

accumulation of funds to pay for future projects including the SBWRP and the completion of the 4th interceptor.⁸¹ The five-year capital improvement plan draws down this balance to \$1.9 million.⁸²

Fund 540 receives some joint participation revenue from sewer projects that are used by other jurisdictions to transport wastewater to WPCP.⁸³

There is an outstanding loan from the Sanitary Sewer Connecting Fee Fund (Fund 540) to the Service Yards Construction and Conveyance Tax Fund⁸⁴ (Fund 436)⁸⁵ for \$2.5 million. This loan will fund the additional improvements necessary to make the facility a fully functional service yard. The loan, including interest at the pooled investment rate, will be repaid in 1999-2000 using the proceeds from the sale of the vacated Las Plumas and Stockton warehouses that will be consolidated into the Central Service Yard.⁸⁶ This loan is shown on the CAFR as “advances to other funds.”⁸⁷

Fund 541 - Sewer Service and Use Charge⁸⁸

Established July 20, 1959. Fund 541 is used to account for the revenues from the sewer service and use charges that are used for the acquisition, construction, maintenance and operation of the City’s sewer system. All the revenues deposited in this fund may be used for (1) direct and administrative costs of the Finance Department in collecting the sewer service and use charges and (2) for direct administrative costs of the department of Public Works in performing any tasks, including but not limited to, inspection, measurement, sampling and testing of sanitary sewer and or industrial waste in connection with the collection of the sewer service and use charge.

Fund 545 – Sewer Service and Use Charge Capital Improvement Fund.

Fund 545 was created as part of the 1997-98 budget process in order to separately account for SSUC proceeds. According to budget documents, this was necessary to comply with Proposition 218. The 1997-98 budget transferred a residual \$5.675 million balance in the Sanitary Sewer Connection Fee Fund and the \$16 million annual transfer for sewer maintenance to the new fund. The 1997-98 capital budget shifted 21 rehabilitation projects and preliminary engineering to the new fund.⁸⁹

Fund 815 and 817 – Trustee Accounts for the CWFA

⁸¹ B-2.2/6-1

⁸² B-2.10/6-397

⁸³ B-2.2/6-1

⁸⁴ B-2.10/6-390

⁸⁵ CAFR 6/30/97 p. 115

⁸⁶ B-2.10/6-390

⁸⁷ CAFR 6/30/97, p. 129

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⁸⁹ B-2.10/6-392

The Bank of America is the fiscal agent for the CWFA bonds and acts as trustee for the bondholders. Funds 815 and 817 track the activities of the Trustee. Funds 537 and 538 are pass-through funds used to collect the money from the City and tributary agencies. Each year the collected money in 537 and 538 is transferred to 815 and 817.⁹⁰

FLOW OF FUNDS

The interrelationship between these funds is complex. Diagram __ is a flowchart showing the flow of money through the various wastewater funds during 1996-97.

⁹⁰ B-2.2/5-1

FLOWCHART OF 1996-97 FLOW OF FUNDS

SSUC FUND FIVE-YEAR SOURCE OF FUNDS

The primary source of revenue to the SSUC Fund is sewer charges. These charges are projected to generate \$68.4 million in revenue in 1997-98. The SSUC Fund is expected to generate \$1.2 million in interest income. In addition, SCVWD is expected to reimburse the Fund for \$1.5 million in ULFT rebates.⁹¹

The unrestricted fund balance (\$32.3 million) is currently at a level slightly higher than guidelines established for the fund, but the Administration expects to draw down the excess for the large capital projects that are planned within the next five years.⁹² The rate stabilization reserve (\$2.0 million) was established in response to covenants in the 1995 SBWRP bonds.⁹³

Table __ shows the sources of funds for the last five years as shown in the City's budget documents.

TABLE __
SSUC FUND FIVE-YEAR SOURCES OF FUNDS

	1993-94 Actual	1994-95 Actual	1995-96 Actual	1996-97 Estimated	1997-98 Adopted	Percent change
SOURCE OF FUNDS						
Beginning Fund Balance:						
Reserve for encumbrances	635,723	293,115	613,523	3,148,408	3,148,408	395.25%
Rate stabilization reserve	0	0	0	2,000,000	2,000,000	n/a
Unrestricted	21,108,344	25,552,133	31,182,197	28,229,335	32,305,292	53.05%
Total beginning fund balance	21,744,067	25,845,248	31,795,720	33,377,743	37,453,700	72.25%
Revenue:						
Residential	46,280,907	48,911,305	49,122,173	50,000,000	50,750,000	9.66%
Commercial	11,237,693	11,991,116	12,234,571	12,850,000	13,235,000	17.77%
Industrial	5,012,299	5,880,600	5,263,104	4,500,000	4,410,000	-12.02%
Sewer installation	52,368	19,950	30,000	35,000	35,000	-33.17%
Interest	612,115	973,407	868,945	1,500,000	1,200,000	96.04%
Penalties	315,394	9,967	78,701	7,500	10,000	-96.83%
Miscellaneous	59,524	3,723	9,252	1,000	0	n/a
SCVWD reimbursements	0	0	0	0	1,500,000	n/a
Litigation reimbursements	1,414,794	436,846	62,500	0	0	n/a
Total revenue	64,985,094	68,226,914	67,669,246	68,893,500	71,140,000	9.47%
TOTAL SOURCE OF FUNDS	86,729,161	94,072,162	99,464,966	102,271,243	108,593,700	25.21%

According to ESD, industrial revenue has declined dramatically due to the closure of Sun Garden cannery. ESD also informed us that penalty revenue has declined

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⁹² B-2.10/4-599

⁹³ B-2.10/4-599

dramatically after 1993-94 because the County “teeterized” sewer fee collections at that time of the County-Redevelopment Agency lawsuit.⁹⁴

SSUC FUND FIVE-YEAR USE OF FUNDS

The 1998-99 budget estimates \$19.9 million in direct expenses out of the Fund, and \$55.3 million in transfers from the Fund to other City funds. Table __ shows the uses of funds for the last five years as shown in the City’s budget documents.

⁹⁴ B-2.2/2-2

TABLE ____
SEWER SERVICE AND USE CHARGE FUND FIVE YEAR USES OF FUNDS

	1993-94 Actual	1994-95 Actual	1995-96 Actual	1996-97 Estimated	1997-98 Adopted	Percent change
USE OF FUNDS						
Operating expenses:						
ean Water Financing Audit	24,143	25,926	28,520	30,000	30,000	24.26%
ollection Costs - SC County	500,150	594,340	600,796	609,080	625,000	24.96%
wer Collection - Finance	318,035	370,130	334,892	310,000	427,142	34.31%
wer Maint. - Streets & Traffic	6,331,192	6,623,637	6,329,133	7,370,575	7,873,562	24.36%
wer Maint. - Public Works	858,853	844,192	685,969	900,000	1,354,405	57.70%
wer Maint. - Gen'l Services	148,830	157,234	149,220	95,000	130,750	-12.15%
wer Maint. - Info Technology	52,752	65,655	53,956	87,000	106,429	101.75%
rowth Mgmt. - PBCE	83,446	85,543	89,213	86,000	125,950	50.94%
gmt Services - City Manager	72,627	38,851	71,237	65,000	72,544	-0.11%
gmt Services - City Attorney	319,735	225,813	230,554	252,000	271,651	-15.04%
ajor Litigation - City Attorney	1,733,363	128,248	(40)	0	600,000	-65.39%
iv'tl Issues - Env'tl Services	1,237,903	1,472,493	1,376,883	1,951,550	6,031,356	387.22%
orkers' Comp Claims	0	0	0	177,500	148,810	n/a
tra Low Flush Toilets	7,800	60,980	923,762	0	0	n/a
ech. Supp. For Water Bd. Hrgs.	10,000	0	0	0	0	n/a
anta Clara Reclamation Syst.	0	2,000,000	0	0	0	n/a
eneral Fund Overhead	0	0	1,750,899	2,070,773	2,092,025	n/a
Total Operating Expenses	11,698,829	12,693,042	12,624,994	14,004,478	19,889,624	70.01%
Interfund Transfers:						
reatment Plant Operating Fund	21,636,000	22,636,000	22,636,000	22,636,000	22,636,000	4.62%
reatment Plant Capital Fund	1,000,000	1,000,000	2,000,000	3,000,000	9,000,000	800.00%
reatment Plant Income Fund	1,028,000	1,028,000	1,025,000	1,028,000	1,028,000	0.00%
/SC Capital Conn. Fee Fund	16,000,000	16,000,000	16,000,000	16,000,000	0	n/a
UC Capital Fund	0	0	0	0	16,000,000	n/a
ond Redemption Fund	187,200	0	0	0	0	n/a
/SC CWFA 1987 Payment Fund	6,567,300	6,613,500	6,623,400	6,623,400	6,628,700	0.93%
/SC CWFA 1995 Payment Fund	0	0	3,507,000	0	0	n/a
terest Earnings (Gen'l Fund)	475,000	500,000	1,623,000	1,500,000	0	n/a
eneral Fund Overhead	2,203,304	1,839,239	0	0	0	n/a
eneral Fund (Health Plan Costs)	0	0	47,829	0	0	n/a
orkers' Comp. Reserve	88,280	(33,339)	0	0	0	n/a
eneral Fund (Workers' Comp Admin)	0	0	0	25,665	39,185	n/a
Total Interfund Transfers	49,185,084	49,583,400	53,462,229	50,813,065	55,331,885	12.50%
Ending Fund Balance:						
reserve for Encumbrances	293,115	613,523	3,148,408	3,148,408	3,148,408	974.12%
ate Stabilization Reserve	0	0	2,000,000	2,000,000	2,000,000	n/a
unrestricted	25,552,133	31,182,197	28,229,335	32,305,292	28,223,783	10.46%
Total Ending Fund Balance	25,845,248	31,795,720	33,377,743	37,453,700	33,372,191	29.12%
TOTAL USE OF FUNDS	86,729,161	94,072,162	99,464,966	102,271,243	108,593,700	25.21%

SSUC FUND OPERATING EXPENSES

Collection Costs

Sewer service and use charges are billed and collected by Santa Clara County. The County charges the City a one percent processing fee for this service. The 1997-98 budget for this service is \$625,000. An additional \$427,000 in collection costs is budgeted to cover the cost of the Sewer Billing unit.⁹⁵

Sewer Maintenance Expenses

Streets and Traffic, Public Works, General Services, and IT bill a total of \$9.5 million in expenses to the sewer fund for sewer maintenance.⁹⁶ According to Public Works, they charge a total of about \$1.4 million directly to fund 541. Most of these charges are labor (based on a cost allocation plan) and a small amount of non-personal expenses. There are two Public Works divisions that work on sewer-related projects – the Sanitary division of Design and Construction, and Engineering Services. They maintain the geographic information system, perform master planning, design, and condition assessments.⁹⁷ It should be noted that according to the April 1996 Infrastructure Maintenance Report, sanitary sewers has an unfunded backlog of \$200,000 per year.⁹⁸

Growth Management – Planning, Building, and Code Enforcement

The Planning department provides WPCP with a quarterly report that analyzes the WPCP impact if all building permits were completed.⁹⁹ The 1997-98 budget for this service is \$126,000; this is an increase of more than 50 percent in the last five years (in 1996-97 it was estimated to cost \$86,000).¹⁰⁰

ESD Expenses

The 1997-98 budget shows \$6 million for ESD and environmental issues.¹⁰¹ Table __ shows a breakdown of ESD expenses charged to Fund 541.

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⁹⁷ B-2.2/6-2

⁹⁸ B-2.2/4-1

⁹⁹ B-2.2/1-1

¹⁰⁰ B-2.10/1-2

¹⁰¹ B-2.10/5-643

TABLE __
1997-98 ESD BUDGETTED USES OF FUND 541¹⁰²

DIVISION	PERSONAL	NON- PERSONAL	TOTAL
Administrative Services	28,223	367,950	396,173
Community Relations	99,401	417,790	517,191
Policy and Planning	84,676	8,635	93,311
Technical Support	15,454	0	15,454
Environmental Enforcement	0	2,000,000	2,000,000
Conservation and Resource Mgmt	<u>598,130</u>	<u>2,411,097</u>	<u>3,009,227</u>
TOTAL	825,884	5,205,472	6,031,356

Administrative Services Division

The Administrative Services division provides accounting services for Fund 541. The 1997-98 budget of \$396,000 includes \$28,000 in staff time, \$18,000 non-personal expenses, and a one-time expenditure of \$350,000 for the previously mentioned study of sewer rates.¹⁰³

Community Relations Division

The 1997-98 budget shows \$517,191 in Community Relations division costs charged to the SSUC Fund to promote flow reduction. Planned activities include focus groups, multi-media advertising, coordination with other agencies to leverage resources, printed materials, and an opinion survey. According to ESD staff, each of the tributary agencies runs their own public relations programs. However, starting this year, they will do joint interagency programs that are funded out of WPCP's operating budget (Fund 513); the budget modification should be in the mid-year budget.¹⁰⁴ It should be noted that the SCVWD also conducts public relations about the ULFT program. For example, a Mercury News article quoted SCVWD officials extensively.¹⁰⁵

Policy and Planning Division

The 1997-98 budget shows \$93,000 in Policy and Planning Division costs including \$85,000 in staff time, and \$9,000 in non-personal expenses.¹⁰⁶

¹⁰² B-2.10/14-2

¹⁰³ B-2.10/14-2

¹⁰⁴ B-2.2/2-2 and B-2.10/5-345

¹⁰⁵ B-2.1/2-1

¹⁰⁶ B-2.10/14-2

Technical Support Division

The 1997-98 budget shows \$15,000 in Technical Support division expenses related to staff time.¹⁰⁷

Environmental Enforcement – Pollution Prevention Financial Assistance Program

The Environmental Enforcement division as budgeted \$2 million to begin a Pollution Prevention Financial Assistance Program as part of the Clean Bay Strategy.¹⁰⁸ These funds were shifted from the Conservation and Resource Management division that previously used these funds for the Financial Incentives Program (FIP) provided loans and grants to commercial and industrial sewer customers for the purpose of water conservation.¹⁰⁹ That program funded process improvements including such things as cooling towers and closed loop systems in which water is continuously recycled.¹¹⁰

Conservation and Resource Management -- Flow Reduction and ULFT Programs

According to the 1997-98 budget, the city is undertaking a series of flow reduction initiatives to reduce wastewater flows in order to comply with RWQCB limits. Fund 541 is funding contractual staffing, printing and advertising, consultant services, and funding for the ULFT program. The on-going cost is estimated at \$2.2 million per year. In addition, the budget includes a rebudget of unexpended 1996-97 funds for flow reduction outreach.¹¹¹ These on-going costs will be partially offset by a \$1.5 million contribution from the SCVWD.¹¹² The Conservation and Resource Management Division administers these programs (Rita Norton is the division manager).¹¹³

The focus of the ULFT program is the flow reduction program mandated by the National Pollutant Discharge Elimination System (NPDES) permit requirements.¹¹⁴ Because ULFT's reduce water use and wastewater by approximately 50 gallons per day, this is considered a cost-effective way of conserving water and reducing wastewater. The SCVWD rebate program offers \$75 back to the purchaser of a new ULFT in replacing their old toilet. Currently, up to two rebates are available to each household. For new constructions and remodeling, the municipal code specifies that ULF toilets are used.¹¹⁵

The NPDES permit program of the early 1990s included flow reduction from the projected installation of 100,000 ULF toilets. In March 1996, ESD requested action on

¹⁰⁷ B-2.10/14-2

¹⁰⁸ B-2.10/5-364

¹⁰⁹ B-2.10/4-601

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¹¹¹ B-2.10/5-368..9

¹¹² B-2.10/5-331

¹¹³ B-2.10/5-368..9

¹¹⁴ B-2.2/12-1

¹¹⁵ This must be in the Uniform Building Code, which is incorporated by reference.

ULFT programs designed to meet flow reduction requirements of SJ Action Plan.¹¹⁶ In 1997, ESD estimated it could meet the flow reduction target of 12 million gallons per day (MGD) by the end of 1996, with a total of 80,000 ULFT's by installing ULFT's in multi-family dwellings (with higher use). In 1997, the goal was to install 25,000 toilets in multi-family dwellings using the San Jose Conservation Corps at an estimated cost of \$3 million -- less a SCVWD reimbursement of \$1.9 million (25,000 rebates at \$75 each).¹¹⁷

In December 1997, ESD requested approval of new ULFT program reimbursing MFD owners for installation costs (est. cost not to exceed \$217,500).¹¹⁸

General Fund Overhead

The 1997-98 adopted budget includes \$2.1 million in General Fund overhead expenses. This was previously shown as an interfund transfer.¹¹⁹ The overhead amount is based on the Finance Department's cost allocation plan, which is applied to personal services (not including fringe). The Accounting Division of Finance does the calculation and transfer to the General Fund independent of ESD.¹²⁰

SSUC FUND INTERFUND TRANSFERS

Once funds are transferred to the Treatment Plant, they are co-mingled with other funds. ESD prepares annual budget justifications for the interfund transfers. In addition, they perform an annual report to the tributary agencies on their share of actual operating costs. In addition, they review each agency's cash balance.¹²¹

Transfer to Treatment Plant Operating Fund (Fund 513)

The 1997-98 adopted budget includes \$22.6 million in transfers from Fund 541 to the Treatment Plant Operating Fund (Fund 513). This amount has increased by less than five percent in the last five years.

Of the total transfer, \$20 million constitutes San Jose's share of the WPCP budget. ESD staff allocates operating costs to San Jose and all tributary agencies after reconciling previous estimated versus actual costs. For example, in 1996-97 San Jose's share of WPCP operating costs was \$36.4 million; the transfer was \$20 million, the difference came from the fund balance of the fund.¹²²

¹¹⁶ B-2.13/6-1

¹¹⁷ In measurement of the 12 MGD, the division conducts samples then extrapolates out by assuming old toilets used 100 gallons per day and the new toilets will use 40-60 per day.

¹¹⁸ B-2.13/1-1

¹¹⁹ B-2.10/1-2

¹²⁰ B-2.2/1-1

¹²¹ B-2.2/1-3

¹²² B-2.2/1-3

The other \$2.6 million of the transfer reimburses WPCP for the in-lieu-of-tax fee that WPCP pays to the General Fund. This transaction was suggested in a General Fund revenue study which found that it was appropriate for the City to charge an in lieu of tax to WPCP and Muni Water based on the fact that if the land was privately owned, the City would receive a share of property tax. Tributary agencies don't contribute to the in-lieu-of-tax payment.¹²³

Transfer to Treatment Plant Capital Fund (Fund 512)

The 1997-98 adopted budget transfers \$9 million to the Treatment Plant Capital Fund. Transfers to Treatment Plant Capital Fund were \$1 million in 1993-94 and 1994-95, increased to \$2 million in 1995-96, and to \$3 million in 1996-97, \$9 million in 1997-98.¹²⁴ It is scheduled to drop to \$6.2 million in 1998-99 and \$4 million per year thereafter.¹²⁵ Annual allocations of expected costs are used to determine contribution amounts from each of the tributary agencies. Contributions are reconciled to actual expenses at year-end, and excess contributions are credited against the next year's contribution amount.¹²⁶

Transfer to Treatment Plant Income Fund (Fund 514)

The 1997-98 adopted budget transfers \$1 million to the Treatment Plant Income Fund.¹²⁷ The City has established an equipment replacement fund to meet State revenue program guidelines. In 1984, TPAC set the annual amount at \$1,663,000. San Jose and the other agencies pay into Fund 514; Santa Clara pays into 512. The expense is treated as an operating cost. On an annual basis, ESD reconciles actual expenses to contributions and transfers the excess to, or covers the deficit from the Treatment Plan Renewal and Replacement Reserve (Fund 531). According to ESD staff, use of Fund 514 is necessary to keep tributary agency contributions separate.¹²⁸

¹²³ B-2.2/1-3

¹²⁴ B-2.10/1-1

¹²⁵ B-2.10/4-602

¹²⁶ B-2.2/1-4

¹²⁷

¹²⁸ B-2.2/1-4

Transfer to SSUC Capital Fund (Fund 545) – previously transferred to the Sanitary Sewer Connection Fee Fund (Fund 540)

The 1997-98 adopted budget transfers \$16 million to the Sewer Service and Use Charge Fund (Fund 545); \$5.675 million in reserves have been transferred. In prior years this \$16 million transfer was made to the Sanitary Sewer Connection Fee Fund (Fund 540).¹²⁹ Fund 545 is a new fund to account for sewer rehabilitation and maintenance projects that are funded by sewer service and use charges.¹³⁰ The Sanitary Sewer Connection Fee Fund will be used to account for sewer expansion projects. The Public Works Department administers both of these funds.¹³¹

Transfer to Clean Water Financing Authority Bond Payment Funds (Funds 537 and 538)

The 1997-98 adopted budget transfers \$6.6 million to the CWFA 1987 Payment Fund.¹³² According to ESD, debt service on SBWRP bonds will be carried by the Sewage Treatment Connection Fee Fund (Fund 539) until that fund is drawn down and no longer able to cover those costs; they will then be shifted back to the SSUC Fund (Fund 541).¹³³

Transfers to the General Fund

In 1996-97, Fund 541 transferred \$1.5 million in interest earnings to the General Fund. As discussed previously, this has been discontinued because of Proposition 218. However, we understand that the Attorney's Office has approved the transfer of interest earnings from the newly established Sewer Service and Use Charge Capital Fund (Fund 545) to the General Fund.¹³⁴

CWFA

The San Jose-Santa Clara Clean Water Financing Authority (CWFA) was created pursuant to the Joint Exercise of Powers Agreement, between the cities of San Jose and Santa Clara to finance the acquisition and construction of additions and improvements to the existing waste water treatment plant and related facilities. The Authority is a component unit of the City of San Jose.¹³⁵

The City, as the administering agent of the Authority, has established certain funds to account for its sewer collections and plant operations including the SBWRP

¹²⁹ B-2.2/1-3

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¹³¹ B-2.2/1-3

¹³²

¹³³ B-2.10/4-602

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¹³⁵ b-3.4/1-1

Fund (which was established to account for construction activity partially financed through the Authority), and the CWFA 1987 and 1995 Bond Payment Funds (which are used to accumulate contributions from participating agencies subsequently transferred to the Authority as base payments).

The bond resolutions require that funds be held by a fiscal agent (a trust department of a qualifying financial institution) as trustee for the bondholders. The fiscal agent is required to maintain separate funds for specified activities. The financial statements reflect all transactions executed by the fiscal agent and the Authority.

Both Santa Clara and San Jose are required to maintain a level of net sewer system revenues at least equal to 125 percent of each of the Cities' respective share of the base payments required in any year for the 1987 Series A and B Revenue Bonds and 115 percent for the 1995 Series A, B, and C Sewer Revenue Bonds. The City has covenanted to increase sewer rentals, rates, fees and charges to the extent necessary to generate those net system revenues.

San Jose is responsible for payment of approximately 87.5 percent and 98.7 percent of the debt service on the 1987A and 1987B Bonds, respectively. Santa Clara is responsible for the remainder. The City is responsible for 100 percent of the debt service on the 1995 Bonds. The City expects to receive contributions from Tributary Agencies to cover approximately 20 percent of the debt service.

TABLE 1
CWFA BONDS OUTSTANDING AS OF JUNE 30, 1997

BOND ISSUE	USE OF FUNDS	AMOUNT
1995 Series A Sewer Revenue Bonds at rates of 4.6% to 5.38%; interest only payable through 2002; interest plus principal payments (ranging from \$1,700,000 to \$8,380,000) in annual installments payable through November 2020.	Net proceeds are being used to fund the City's share of the costs of Phase I of the SBWRP.	\$68,820,000
1995 Series B Sewer Revenue Bonds at variable rates, as defined in the bond indenture (3.9% as of June 30, 1997; interest only payable through 2006; interest plus principal payments (ranging from \$3,900,000 to \$5,000,000) in annual installments payable through November 2011.	Same as for 1995 Series A Sewer Revenue Bonds	\$26,700,000
1995 Series C Sewer Revenue Bonds at rates of 3.9% to 4.7%; payable in annual installments ranging from \$205,000 to \$1,925,000 with the final installment due in November 2004. Original issue totaled \$12,230,000	Net proceeds used to defease a portion of the Authority's outstanding 1987 Series B Bonds (issued to finance improvements to WPCP).	\$12,035,000
1987 Series A Revenue Bonds at rates of 6.75% to 7.25%; payable in annual installments ranging from \$4,245,000 to \$8,560,000 with the final installment due in October 2002	Net proceeds used to defease a portion of the Authority's outstanding 1983 Series A and B Bonds (issued to refinance prior improvements to WPCP).	\$40,775,000
1987 Series B Revenue Bonds at a rate of 6.75% payable in an annual installment of \$1,215,000 which is due in October 1997	Same as for 1987 Series A Revenue Bonds.	\$1,215,000
Total		\$149,545,000
Less unamortized discount		\$2,961,104
Net bonds payable at June 30, 1997		\$146,583,896

WPCP

The San Jose/Santa Clara Water Pollution Control Plant (WPCP), is located on an approximately 1,700 acre site in the Alviso area of San Jose, the Treatment Plant discharges to Artesian Slough, which flows into the southern portion of San Francisco Bay. WPCP was first constructed in 1956 with a capacity of 36 million gallons per day (mgd). Today WPCP's capacity is 167 mgd; peak week flow in 1997 was 140 mgd.¹³⁶ The WPCP Operating and Maintenance Budget for 1997-98 is \$55.7 million with 349 FTE.¹³⁷

¹³⁶ B-2.13/2-2

¹³⁷ B-2.10/16-iv

Under the terms of the May 8, 1959 agreement between San Jose and Santa Clara, provides for both cities to mutually own, operate, maintain and use the Treatment Plant with the City of San Jose, acting as the administrative agency for the Treatment Plant, with authority and responsibility for operating the facility and determining annual operating and capital costs.¹³⁸ The City's financial statements include WPCP assets. The City of Santa Clara's share of fund balance is shown in the financial statements as "City of Santa Clara equity in operations of Wastewater Treatment System."¹³⁹

The 1983 Master Agreement

The jointly owned facility provides wastewater treatment services to other agencies in the service area termed the "tributary agencies". The tributary agencies are the City of Milpitas, West Valley Sanitation District, Cupertino Sanitary District, Burbank Sanitary District, Sunol Sanitary District and County Sanitation District 2-3.¹⁴⁰ In 1983, WPCP's tributary agencies entered into a master agreement for wastewater treatment, which outline payment obligations of each agency. These agreements were amended in 1985, and again in 1995 (to include the SBWRP).¹⁴¹

The master agreement outlines capacity rights based on flow (mgd), future capacity rights, amounts payable by user agencies to the cities of San Jose and Santa Clara (first parties), and the composition and responsibilities of the Treatment Plant Advisory Committee (TPAC). It specifies that

- Payments related to plant expansion or future improvements shall be in proportion to capacity rights, and
- Payments related to operations and maintenance shall be determined based on actual discharge into the plant during the year.¹⁴²

Treatment Plant Advisory Committee

The Treatment Plant Advisory Committee (TPAC) was created in 1959. The powers and duties of TPAC are to tender its advice with respect to any and all matters relating to the treatment plant and its maintenance, repair, expenses, replacement, improvement and operation, and policies relative thereto.¹⁴³

TPAC meets monthly. The total TPAC voting membership is presently nine members consisting of four members from San Jose, two members from Santa Clara, and one member each from the City of Milpitas, Cupertino Sanitary District and West Valley Sanitation District.¹⁴⁴ Its members include Pat Dando, Margie Fernandes, and Alice

¹³⁸G-2.1/4-1

¹³⁹ B-2.2/1-5

¹⁴⁰

¹⁴¹ B-3.3/1-1

¹⁴² B-3.3/5-1

¹⁴³B-2.5/8-1 TPAC Procedures

¹⁴⁴B-2.5/8-1 TPAC Procedures

Woody, and Ralph Qualls. Staff to TPAC include Ron Garner and Sharon LeBaudour (WPCP), and Mollie Dent (Attorney).¹⁴⁵

Annual Distribution of WPCP Operating and Maintenance Costs

Operation and maintenance costs and capital expenditures of the Treatment Plant are estimated annually by the Environmental Services Department staff. These estimates are reviewed, adjusted and recommended as a proposed budget for the Treatment Plant by TPAC to the City Council of San Jose, as the administering agency. The City Council of San Jose reviews and adopts the proposed budget during its annual budget deliberations.¹⁴⁶

ESD sends the tributary agencies an annual estimate of the distribution of operating and maintenance costs. These reports show the tributary agencies' shares of estimated costs for the coming year.¹⁴⁷ Payments are due quarterly.¹⁴⁸ For example, the 1997-98 operating and maintenance cost distribution was as follows:

TABLE __
1997-98 PROJECTED WPCP OPERATING AND MAINTENANCE COST
DISTRIBUTION¹⁴⁹

AGENCY	PERCENTAGE	O&M COST
San Jose	63.117	\$ 32,820,800
Santa Clara	14.162	7,364,200
West Valley Sanitary District	9.675	5,031,100
Cupertino	4.608	2,396,100
Milpitas	6.454	3,356,100
County Sanitation District 2-3	1.512	786,200
Burbank	0.318	165,200
Sunol	0.154	80,300
TOTAL	100.000	\$ 52,000,000

Annual Distribution of WPCP Capital Costs

The Technical Support Division of ESD is responsible for planning, designing and constructing new wastewater treatment facilities¹⁵⁰. The costs of Treatment Plant capital improvements are allocated proportionally to all service areas represented by the Treatment Plant Advisory Committee (TPAC) based on each agency's flow capacity

¹⁴⁵ Recent TPAC minutes in office files.

¹⁴⁶ Preliminary Survey #9601

¹⁴⁷ B-2.9/2-1 thru B-2.9/4-1

¹⁴⁸ B-3.3/5-1

¹⁴⁹ B-2.9/2-page 1 of 13

¹⁵⁰ G-2.1/4-1 pg. 26

(including presence of and chemical concentration of certain elements in the untreated waste).¹⁵¹ Table __ shows the 1997-98 projected distribution of capital fund project totals.

TABLE __
1997-98 PROJECTED WPCP CAPITAL FUND PROJECT COST
DISTRIBUTION¹⁵²

AGENCY	PERCENTAGE	O&M COST
San Jose	66.162	\$ 11,686,100
Santa Clara	14.846	2,622,200
West Valley Sanitary District	6.928	1,223,600
Cupertino	4.360	770,200
Milpitas	6.040	1,066,900
County Sanitation District 2-3	1.110	196,100
Burbank	0.238	42,000
Sunol	0.316	55,900
TOTAL	100.000	\$ 17,663,000

Annual Report on WPCP Capacity

The Master agreements require annual report on plant capacity. According to the report that was distributed to the tributary agencies for 1997:

- Total plant capacity during 1997 was 167 MGD.
- Peak dry weather flow of 140 MGD occurred during the week of July 14-18.
- Thus, available capacity was 27.0 MGD.

The report also showed that:

- San Jose's share of 1997 plant capacity was 105.62 MGD.
- San Jose's peak dry weather flow was 90.41 MGD.
- Thus, San Jose's available capacity was 15.21 MGD.¹⁵³

SBWRP

To address regulatory agency concerns, the City of San Jose adopted the San Jose Action Plan in 1991. The plan proposed diverting up to 70 mgd of effluent through the development of various reclamation projects: water recycling, marsh mitigation, and water conservation.¹⁵⁴ The RWQCB approved the San Jose Action Plan and recommended that the SWRCB accept the plan instead of the flow limit.¹⁵⁵ In 1993,

¹⁵¹X-11, CIP to TPAC FY1996-2000

¹⁵² B-2.9/5-page 2 of 6

¹⁵³ B-2.13/2-1

¹⁵⁴Letter to California RWQCB from City of San Jose, December 22, 1992.

¹⁵⁵Draft Environmental Impact Statement for the South Bay Water Recycling Program, U.S. Bureau of Reclamation, July 1995, p.1-3 and 2-1.

RWQCB issued WPCP an NPDES permit that limited the discharge to 120 mgd in the summer months and required the City to implement the Action Plan in two phases.¹⁵⁶

The SBWRP is a joint project between the cities of San Jose, Santa Clara, Milpitas, West Valley Sanitation District, Burbank Sanitary District, Cupertino Sanitary District, Sunol Sanitary District and County Sanitation District No. 2-3. Reclaimed water will be used for industrial and a variety of irrigation uses, including landscaping and agriculture in institutional, commercial, and residential areas. It is expected to cost \$139 million.¹⁵⁷

The project is primarily being financed by proceeds from the CWFA \$107 million bond issue, \$1.75 million Bureau of Reclamation grant, capital reserves (e.g., treatment plant capital fund, WPCP construction fund, and sewage treatment plant connection fee fund), and state funds.¹⁵⁸

The City is 100 percent responsible for the debt service of the 1995 bonds, which are payable beginning in 1996 through 2021. The City has pledged net system revenue as security for its obligations to make base payments. Moreover, the City has covenanted to increase sewer rentals, rates, fees and charges necessary to generate those net system revenues.¹⁵⁹ The City has made the assumption that sewer charges will increase 4.6 percent and 5.3 percent for fiscal years 1999 and 2000.

Phase I annual costs are expected to be \$10.3 million for capital and \$1.4 million for operation and maintenance. Capital costs for the project will be allocated among program participants based on wastewater flows only. The current allocations are 64 percent to San Jose, 15 percent to Santa Clara, 8 percent to West Valley Sanitation District, 7 percent to Milpitas, and the remaining 6 percent to Cupertino, Burbank, and Sunol sanitation districts. If Phase I capital costs are \$10.3 million, San Jose's share will be about \$6.6 million.¹⁶⁰

It is expected that revenue from the sale of 9,000 acre feet of reclaimed water will generate about \$1.7 million per year during Phase I. The Santa Clara Valley Water District will subsidize reclaimed water use by providing a \$93 per acre foot subsidy. Taking the subsidy into consideration, the total reclaimed water sales revenue should be enough to cover operation and maintenance expenses. However, this revenue may not be enough to cover the cost of processing the reclaimed water.¹⁶¹ The Director of the SBWRP estimated that the cost of producing an acre foot of reclaimed water will be around \$800 to \$900.¹⁶²

¹⁵⁶Findings of the Blue Ribbon Committee, September 19 and October 3, 1994.

¹⁵⁷ B-2.2/1-4

¹⁵⁸Memorandum from Bartle Wells Associates to Eric Rosenblum, trial financial concept, September 23, 1994.

¹⁵⁹Official Bond Statement, p. 2.

¹⁶⁰Memorandum from Bartle Wells Associates to Eric Rosenblum, trial financial concept, September 23, 1994.

¹⁶¹Table 8, Memorandum from Bartle Wells Associates to Eric Rosenblum, trial financial concept, September 23, 1994.

¹⁶²Interview with Eric Rosenblum, Director, SBWRP, December 13, 1995.

Current Status of SBWRP

In January 1998, ESD briefed the TPE committee with a quarterly status report for SBWRP. Approximately 75% of construction complete; cost projections within approved budget. No major project cost overruns are foreseen. The SBWRP has a total of 70 customers signed up for an expected diversion of 9.6 mgd; the target is 200 customers with a diversion of 15 mgd by May 1998.¹⁶³ That's only a few months away.¹⁶⁴

PREVIOUS AUDIT FINDINGS

In 1996, the City Auditor's Office conducted a preliminary survey of the ESD and all its divisions. We have included information from that document in this preliminary survey.

In 1992, at the request of the Acting Director of OEM, the City Auditor prepared a preliminary survey, listing of threats, and preliminary assessment of reported controls. Our report, "A Preliminary Assessment of the Office of Environmental Management's Internal Control Structure," included threats related to the ULFT program, FIP program, determining funding sources, and verification of revenue.¹⁶⁵

In 1997, KPMG's management letter to the City commented that ESD accounting functions should be better integrated.¹⁶⁶ ESD is adding an Account II in 1997-98 to help the department comply with the KPMG recommendation that ESD accounting staff "be more closely linked to operational matters and management reporting."¹⁶⁷

¹⁶³ B-2.13/7-3

¹⁶⁴ Editorial comment

¹⁶⁵ B-1.11/2-1

¹⁶⁶

¹⁶⁷ B-2.10/4-330

SUMMARY OF AUDIT ISSUES

Council concerns:

- Councilmember Diquisto requested the audit in 1995. He is primarily concerned about the segregation of money between WPCP, TPAC, and other City funds.¹⁶⁸
- Councilmember Fiscalini's office has long-standing concerns about the ULFT rebate program, including new contingency plan increases in ULFT cost estimates.¹⁶⁹ Staff wonders if the program has outlived its usefulness since federal regulations now require that all toilets manufactured in the U.S. are low-flow.

Regulatory requirements:

- Review compliance with Municipal Code provisions.
- Review compliance with State Water Quality Control Board requirements.
- Review effect of Proposition 218 on sewer and wastewater funds.

Sewer Rate Structure:

- Rates - Document annual rate adoption process. Assess the adequacy of ESD's pending rate review (the RFP is being prepared to hire a consultant).
- Follow the logic through the SWQCB guidelines to the City's cost allocation program to the adopted rate structure.
- The City of Portland issues an annual performance evaluation of the city's environmental services. Performance statistics include sewer/storm operating costs per capital, annual volume of wastewater treated, average monthly bills for garbage (\$17.60 for a 32-gallon can; San Jose is \$13.95), etc. Compare our over-all cost for services to other jurisdictions. Compare our administrative costs to other jurisdictions.

Sewer Billing Unit (Treasury):

- Accuracy of fee calculations.
- Appropriateness and documentation of loss adjustment factors.

¹⁶⁸ B-0/2-2

¹⁶⁹ B-0/2-2

- Accuracy of customer database.
- Cost effectiveness of County collection versus consolidated billing.

Industrial Sewer Billing (ESD):

- Accuracy of fee calculations.
- Accuracy of customer database.

Allocation of costs to the Sewer Fund:

- Appropriate allocation of ESD costs to the Sewer Fund.
- Appropriate transfers of sewer revenue to other funds -- Most of the sewer charge revenue is transferred other funds and expended there. Are these transfers appropriate? Is it appropriate to transfer and commingle the money? If not, should money be accounted for separately? Do the transfers constitute a reasonable charge for services rendered?
- Fund 541 pays approximately \$30,000 for the CWFA audit costs annually. Would the accounting trail be clearer if this cost was charged to the CWFA funds?

TPAC Cost Distribution:

- Review calculation of WPCP cost distribution to tributary agencies - What is the formula for cost distribution? Do they use flow meters and how reliable are they? Review the procedures for accumulating costs that are attributed to the Joint Authority. Assess whether costs are properly allocated.
- Review allocation of costs for SBWRP to participating agencies.
- Allocation of personal services costs to the sewer fund. Review 1996 DMG cost allocation study.
- Review allocation of ESD's Conservation and Resource Management Division expenses with TPAC. What is ESD's policy regarding joint funding of these expenses with TPAC?
- How are costs allocated for wastewater-related community relations efforts, such as the Clean Bay Strategy Outreach (\$500,000 in 1995-96), Water Reclamation

Outreach (\$407,000 in 1995-96), and Flow Reduction Public Education (\$465,000 in 1994-95)? What is ESD's policy regarding joint funding of Community Relations Division expenses with TPAC?

- What is advertising budget for ULFT and FIP? How much does San Jose spend on ULFT advertising relative to the tributary agencies?
- Cost sharing -- Add up total contributions and transfers from various agencies and San Jose. Are we paying our fair share?

Administrative Services and Fund Accounting Workload:

- Review 1996 DMG consultant report on appropriateness of direct charges versus cost allocations to various funds. Review effect on the accounting section's workload.
- Review fund accounting system for possible simplification. How did this complicated accounting get established? How many people does it take to do the accounting? Do they know what each other is doing? How many staff hours are devoted to maintaining this system?
- Loan agreements – Are they adequately documented? Does loan activity disguise the fact that some funds are more than cost-recovery or less?
- Cash – Add up the cash and fund balances in all these funds. Is it committed?